BILL # HB 2271 | **TITLE:** tax deduction; 529 education plans

SPONSOR: Huffman | **STATUS:** As Introduced

REQUESTED BY: House | **PREPARED BY:** Bethany Nicholas

FISCAL ANALYSIS

Description

Beginning in tax year 2004, this bill would allow an individual income tax deduction up to $500 in any one taxable year, for the amount of contributions made to a qualified state tuition program determined pursuant to section “529” of the Internal Revenue Code.

Estimated Impact

This bill is projected to reduce General Fund individual income tax revenues by between $(343,600) and $(804,800) in FY 2005 and $(453,700) and $(1,062,500) in FY 2006.

The Department of Revenue does not have a cost estimate for this proposal.

Analysis

According to the Commission for Postsecondary Education, there are 34,600 “529” college savings accounts currently in existence. Based on historical data, the Commission projects the number of accounts will grow to approximately 46,400 in Calendar Year (CY) 2004 and 60,200 in CY 2005. HB 2271 would allow any individual contributing to a “529” account to take a $500 deduction. The fiscal impact will depend on how many taxpayers take the deduction as part of their itemized tax returns. Assuming that a $500 deduction will be claimed each year for each account and that all contributors itemize deductions on their tax returns, we estimate that the Arizona taxable income will decrease by $(22,800,000) in 2004 and $(30,100,000) in 2005. The Department of Revenue, however, reports that in tax year 2001, only 42.7% of all taxpayers itemized deductions. Assuming that 42.7% of contributors to “529” college savings accounts will itemize, Arizona taxable income would decrease by $(9,735,600) in 2004 and $(12,852,700) in 2005.

Applying an average effective tax rate of 3.53% (derived from the Department of Revenue’s 2002 Abstract) to the amount of taxable income lost, we estimate that the state’s individual income tax liability will decrease by between $(343,600) and $(804,800) in tax year 2004 and $(453,700) and $(1,062,500) in tax year 2005. However, from a budgetary perspective, the fiscal impact will not occur until FY 2005 and FY 2006, respectively. Although tax liability is accrued on a calendar year basis, final tax payments and refunds are not issued until the following calendar year.

The breakdown above provides a static analysis of this bill’s prospective fiscal impact. Presumably, the creation of this deduction would create an incentive to taxpayers to invest in a “529” college plan and therefore the number of accounts and contributors may increase above current estimates. In addition, the new $500 deduction may influence taxpayers’ decisions regarding whether to take the standard deduction or to itemize. However, there is insufficient information available to complete a dynamic analysis that would include the impact of such changes in taxpayer behavior.

Local Government Impact

Incorporated cities and towns receive a percentage of individual and corporate income taxes as urban revenue sharing. Under current law, the urban revenue sharing percentage will be 15.0% in both FY 2005 and FY 2006. This means that local governments would lose between $(51,500) and $(120,700) in FY 2007 and $(68,000) and $(159,400) in FY 2008 under this bill.

1/29/04